

Internal Revenue Service
Director, Exempt Organizations

Department of the Treasury
P.O. Box 2508 - EP/EO
Cincinnati, OH 45201

Date: JUN 21 2002

Employer Identification Number:

Person to Contact - I.D. Number:

Contact Telephone Numbers:

Phone
FAX

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides, in part, that:

A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

Sincerely,

Director, Exempt Organizations

Enclosures: 3

Enclosure I

FACTS:

FORMATION AND MEMBERSHIP

You were formed under the non-profit laws of the state of [REDACTED]. You subsequently filed an Amendment to the Articles of Incorporation on [REDACTED]. According to this Amendment, [REDACTED] is "organized exclusively for charitable, religious, educational, and scientific purposes, including, for such purposes as the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code, or corresponding section of any future federal tax code".

According to your bylaws, your primary purpose is to promote "... the economic recovery of individuals adversely affected by the events on [REDACTED] through educational training in the art of entrepreneurialism. The organization will provide grants sufficient to support identified individuals through the first year of training under a system which will closely monitor their progress."

You are not a membership organization; therefore, no provisions have been made in the bylaws regarding membership requirements.

ACTIVITIES

The following information was submitted with the initial Form 1023 application:

- Your planned activities include the following:

"identify individuals who have become economically distressed as a result of events occurring on [REDACTED], [REDACTED] by promoting their recovery through educational training in the art of entrepreneurialism via [REDACTED] system. You will provide grants sufficient to support identified individuals through the first year of training under a monitoring system which will enable you to measure and adjust to individual needs of the recipient."

- You will receive support in the form of contributions from individuals and business entities.
- You anticipate awarding approximately [REDACTED] grants per year. These grants will average \$[REDACTED]. Grants will be awarded in \$[REDACTED] and \$[REDACTED] increments.
- Grants will be awarded to those individuals who have suffered adverse financial consequences due to the events of [REDACTED] or any other

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There are no restrictions due to race. The employment status of the prospective recipient or any relative of the prospective recipient will be considered depending on the severity of their financial situation. However, no relatives of the selection committee will be allowed to participate in grants.

ADDITIONAL FACTS

your response dated [REDACTED] the following information was provided:

The individuals will participate in activities that will give them the effective tools and education necessary to promote entrepreneurialism and aid in operating a successful home based business. The activity will be overseen by individuals associated with [REDACTED] system.

Grant recipients will receive their apprenticeship training in various locations such as at personal residences of distributors or by participating and/or attending seminars where the subject matter pertains to learning the [REDACTED] system.

- Grant funds may be used for training materials and seminars produced by [REDACTED], for travel expense associated with training and sales activities, and for other expenses related to such activities.
- Recipients of grants will include relief workers, families of victims, individuals whose place of employment was terminated or cut back due to the adverse economic impact of [REDACTED], as well as those who demonstrate financial need as a result of the events or similar [REDACTED].

- [REDACTED] system is a proven business plan which allows independent home based business owners the opportunity to sell products and gain profits from retail sale as well as commissions based on the sale of product volume. Your founders are related to [REDACTED], but you will not be controlled by [REDACTED].

- Once grants have been awarded, grant recipients will be monitored each financial quarter to verify their active participation in the [REDACTED].
- Grant recipients must fulfill the requirements for each financial quarter in order to continue receiving grant money. If the grant participant fails to accomplish the quarterly tasks, they will no longer receive the grant. Quarterly tasks include such requirements as locating a specific number of customers, sponsoring additional [REDACTED] distributors, and attending conferences or seminars.
- [REDACTED] will match all charitable contributions made.
- It appears that in the future, seven out of a total of fifteen of your directors will be related to [REDACTED].

In a conversation with [REDACTED] on [REDACTED] the following clarifications were made regarding your activities:

- [REDACTED] is a training system to train people to be entrepreneurs. Regular participants in this system receive training materials, pay wholesale prices for products and sell those products at a markup. These participants are independent distributors for [REDACTED] who operate their own businesses.
- [REDACTED] will provide grants to people to participate in this system. Grantees must demonstrate financial need and must meet the previous described benchmarks before grant money is released.
- Grantees receive products at no cost ([REDACTED] will donate the products at cost to [REDACTED] as part of the individual's grant). Grantees then sell these products and receive all proceeds of their sales. They are not required to reimburse [REDACTED] for the cost of the goods sold.
- Approximately [REDACTED] % of the participants in the [REDACTED] system stay with [REDACTED] as independent distributors when their training is complete. However, they are not required to use [REDACTED] as their sole distributor. They are allowed to purchase products from other distributors.
- Although there is no requirement for participants to remain with [REDACTED] as independent distributors, it is very likely that they will. Therefore, it is very likely that participants in the grantee program will also remain distributors for [REDACTED] when they complete the program.
- You have represented that your future Board would have a majority of individuals not connected with [REDACTED]. However, you do not plan to provide grants for business/sales training provided by any entity other than [REDACTED].

In a written response dated [REDACTED] the following information was provided:

- [REDACTED] is a for-profit [REDACTED] company which sells products wholesale to independent salespeople who then in turn resell the products for profit.

In a written response dated [REDACTED] you indicated that the facts contained above, and presented in our letter dated [REDACTED], were correct.

LAW:

Section 501(c)(3) of the Internal Revenue Code requires that, to qualify for tax exemption under this section, an organization must be organized and operated exclusively for certain enumerated purposes and no part of its net earnings may inure to the benefit of any private shareholder or individual. These purposes include religious, charitable, scientific, testing for public safety, literary, educational, fostering national or international amateur sports competition, and the prevention of cruelty to animals or children.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations states, in part, that charitable purposes include relief of the poor and distressed or of the underprivileged.

Sections 1.501(c)(3)-1(c)(2) and (d)(1)(ii) of the Regulations state that an organization whose net earnings inure to the benefit of private shareholders or individuals or which is operated for the benefit of private interests is not operated exclusively for exempt purposes.

In Better Business Bureau of Washington, D.C., Inc. v. U.S., 326 U.S. 179, the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

In est of Hawaii v. Commissioner, 71 T.C. at 1080-81, the Court stated that a critical determination is not whether transactions with a for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the exempt organization.

In that case, a non-profit organization was involved in transactions with three for-profit corporations. The transactions were made at fair market value and the non-profit organization contended that they had no commercial purpose of their own and that the fact that the for-profit corporation may receive a benefit from the transaction was not a ground for denial of tax-exempt status.

However, the court held that the non-profit organization was a part of a franchise system that was operated for the benefit of the for-profit corporation and that its affiliation with this system taints it with a substantial commercial purpose.

In Church by Mail, Inc. v. Commissioner, 765 F.2d 1387, 1390 (9th Cir. 1985), the court held that an organization operated for the substantial non-exempt purpose of providing a market for a for-profit corporation was not exempt under section 501(c)(3) of the Code.

In that case, a non-profit organization was formed to promote religion through the distribution of printed religious messages. The non-profit organization was

related to a for-profit corporation that provided the printing and mailing services for the non-profit organization. The for-profit corporation also provided similar services to others as part of its normal commercial operations.

The court determined that the non-profit organization was operated for the non-exempt purpose of providing a market for the for-profit corporation's services and that this non-exempt purpose would preclude exemption under section 501(c)(3) of the Code.

TAXPAYER'S POSITION:

In a written response dated [REDACTED], you quoted Regulations 1.501(c)(3)-1(e)(1) which provides that the mere fact that an organization engages in trade or business does not result in denial of tax exempt status if such trade or business is in furtherance of such organizations exempt purpose.

You state that the activities of the applicant "will not be carried on in such a manner that [REDACTED] will substantially benefit from its operations". You state that "[REDACTED] does not benefit at all from the sale of goods that are offered to the grant recipients and the prospect of the increase of the [REDACTED] base is purely speculative and non-obligatory".

In addition, [REDACTED] have cited San Francisco Infant School v. Commissioner, 69 T.C. 957, 965-966. In this case, the court held that a substantial nonexempt activity that was an integral and inseparable part of an exempt activity did not result in denial of tax exemption.

In your [REDACTED] response, you further stated that "the purpose and objective to which the income of [REDACTED] is devoted is the ultimate test in determining whether it is operated exclusively for an exempt purpose".

CONCLUSION:

Based on the information provided to date, you do not qualify for exemption under section 501(c)(3) of the Code.

Specifically, the Code and Regulations limit exemption to those organizations that are organized and operated exclusively for charitable purposes. The Regulations state that the operation of a trade or business will not necessarily preclude exemption if such trade or business is in furtherance of an exempt purpose. However, the Regulations also state that an organization whose net

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earnings inure to the benefit of private shareholders or individuals or which is operated for the benefit of private interests, is not operated exclusively for exempt purposes. Therefore, because your benefits are inuring to a related for-profit organization, you are not operated in furtherance of an exempt purpose and do not meet the operational test for exemption.

Your situation is not analogous to San Francisco Infant School v. Commissioner. In that case, denial of exemption had been based on the contention that the applicant primarily provided custodial care to pre-school children, rather than primarily providing educational services. The court found that custodial care was a necessary component of providing education to children of this age. Moreover, there was no issue of benefit to private business interests. Although providing funding for business training to individuals in adverse financial circumstances may be a charitable purpose, you have chosen to provide assistance only to persons who agree to train in the ██████████ system. The result of this activity is a benefit to ██████████ through promoting awareness of their products, increasing the sales of such products, and recruiting additional distributors for these products, as further discussed below. Accordingly, we find that the private benefit accruing to ██████████ is a substantial non-exempt purpose that precludes exemption.

You are similar to est of Hawaii v. Commissioner. The transactions that you have with ██████████ appear to be made at fair market value and you do not appear to have commercial activities of your own. However, ██████████ will receive substantial benefit from your activities. Approximately ██████████ of the grant recipients can be expected to remain with ██████████ as independent distributors. In addition, as part of their grant requirements, the grant recipients must recruit and sponsor additional distributors for ██████████, and must meet specific sales goals, including building up an increasingly large customer base for ██████████ products. Therefore, ██████████ is receiving the benefit of additional public awareness of its products, additional distributors, and additional profits from the sales of its products to the distributors.

As noted above, it is your contention that your exempt purposes of providing employment training to persons in adverse financial circumstances, rather than the means by which these purposes are achieved, should determine your qualifications for tax-exempt status. Although all of your funds are to be granted to recipients for training purposes, this is not the only factor to be taken into consideration when determining whether an organization qualifies for exemption. You are similar to the organization described in the est case because your entire enterprise is to be carried on in such a manner that a for-profit organization will benefit substantially from your operations.

In addition, you are similar to Church by Mail, Inc. v. Commissioner. Market America, Inc. provides its training services and distributorship opportunities, at regular rates, to other persons who are not participants in the grant program. By operating a grant program that will in the long run increase the number of

distributors for [REDACTED], you are essentially providing an increased market for [REDACTED] services and products.

You state that the prospect of an increase in [REDACTED] distributor and customer base is "speculative". However, although the grant recipients are not obligated to stay with [REDACTED], it is very likely that they may. We again quote a previous conversation in which it was indicated that approximately [REDACTED] of the grant participants could be expected to remain with [REDACTED] as independent distributors.

In addition, as part of the grant requirements the grantees are required to sponsor a total of six new distributors during the one-year grant period. These new distributors are part of [REDACTED] regular program and are not grantees. In your application you indicated that you anticipate making [REDACTED] grants per year. This would result in approximately [REDACTED] new distributors each year for [REDACTED] as a direct outcome of your activities.

You appear to have a general charitable intent of providing grants to those individuals who have been adversely affected by the events of [REDACTED] as well as [REDACTED], for the purpose of providing them with training in the art of entrepreneurship. However, you also will provide a private benefit to a for-profit corporation, [REDACTED] by promoting and increasing sales of their products. Therefore, as in the Better Business Bureau case, although you have a charitable purpose, the presence of this non-exempt purpose is substantial in nature and will preclude exemption.

In conclusion, your proposed activities will result in substantial benefit to private individuals; consequently, you will be operated for the benefit of private interests. Accordingly, you are not operated exclusively for exempt purposes as described in section 501(c)(3)-1(c)(2) and (d)(1)(ii) of the Regulations this type of organization, and you do not qualify for exemption under section 501(c)(3) of the Code.

Department of the Treasury - Internal Revenue Service
Consent to Proposed Adverse Action
(All references are to the Internal Revenue Code)

Case Number

Date of Latest Determination Letter

Employer Identification Number

Date of Proposed Adverse Action Letter

Name and Address of Organization

JUN 21 2002

I consent to the proposed adverse action relative to the above organization as shown below. I understand that if Section 7428, Declaratory Judgements Relating to Status and Classification of Organizations under Section 501(c)(3), etc. applies, I have the right to protest the proposed adverse action.

NATURE OF ADVERSE ACTION

☒ Denial of exemption

☐ Revocation of exemption, effective.

☐ Modification of exemption from section 501(c)() to section 501(), effective

☐ Classification as a private foundation described in section 509(a), effective

☐ Classification as an private operating foundation described in sections 509(a) and 4942(j)(3), effective for

☐ Classification as an organization described in section 509(a)(), effective

☐ Classification as an organization described in section 170(b)(1)(A)(), effective

If you agree to the adverse action shown above, please sign and return this consent. You should keep a copy for your records.

If you sign this consent before you have exhausted your administrative appeal rights, you may lose your rights to a declaratory judgement under section 7428.

(Signature Instructions on Back)

Name of Organization

Signature and Title

Date

Signature and Title

Date